

The State Bar of California

Client Security Fund - 2010 Activities Report

Public Protection Program

The Client Security Fund, established by bar-sponsored legislation in 1972, represents one of the State Bar's major efforts to achieve its public protection goals. In addition to disciplinary procedures, as part of the Bar's public service, the Fund helps to alleviate injury to legal consumers who sustain money or property loss as the result of dishonest conduct by a member of the Bar. The Fund is designed to reimburse victims who have lost money or property due to theft, or an act equivalent to theft, committed by a lawyer acting in a professional capacity.

The Fund provides the legal profession with a unique opportunity to promote public confidence in the administration of justice and the integrity of the legal profession. It is also a cost-effective way of providing reimbursement to victims that is generally not available from any other source. The Client Security Fund works closely and cooperatively with the State Bar's lawyer discipline system and the State Bar Court to achieve the Fund's objectives--to come to the aid of those clients who have suffered a loss caused by a diminutive number of errant lawyers.

The Fund is primarily financed by an annual assessment added to the membership dues paid by California lawyers (currently \$40 per active member and \$10 per inactive member). These assessments are applied only for the purposes of Fund payments and costs associated with the Fund's administration. Effective January 1, 2009, the Board of Governors increased the maximum payment to an applicant from \$50,000 to \$100,000 for losses occurring on or after January 1, 2009. The Board also eliminated the "marriage penalty" by allowing spouses to be treated as separate applicants.

Beginning in August 2009, the filing rate for new applications began to increase significantly due to loan modification losses. On December 31, 2010, the Fund had 6,872 applications pending as compared to the 3,738 pending at year end 2009 and 902 at year end 2008. The Client Security Fund estimates that approximately 2/3 of the pending cases are based on loan modification losses. Since its inception, the Fund has reimbursed applicants approximately \$96 million. In 2010, the Fund paid \$3,331,124 on 267 awards. The most typical losses reported are theft of client personal injury settlement funds and failure to refund fees when the lawyer performed no work, which includes losses caused by the loan modification schemes.

Rules and Coverage

The Fund is governed by the Client Security Fund rules which were adopted by the Board of Governors and made effective for all applications filed on or after January 1, 2010. The new rules simplified the language but did not result in substantive changes of the Rules of Procedure, Client Security Fund Matters, which still apply to applications filed prior to January 1, 2010.

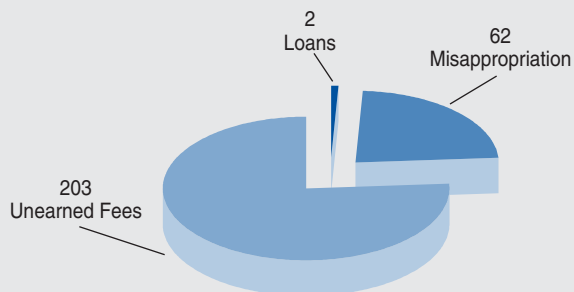
The rules set forth the scope and purpose of the Fund, the authority of the Client Security Fund Commission, the requirements for reimbursement, the application process, the confidentiality of the Fund records, and judicial review of Commission decisions. An applicant or Respondent lawyer may seek judicial review of a Final Decision of the Commission in the superior courts of the state under section 1094.5 of the Code of Civil Procedure.

Number of Applications Paid by Category

In 2010, the Fund paid out \$3,331,124 on 267 awards.

The largest number of applications paid was in the "Unearned Fees" category (76.03%). The second largest category by size was the "Misappropriation" category (23.22%) with "Loans" representing less than 1% of the applications paid.

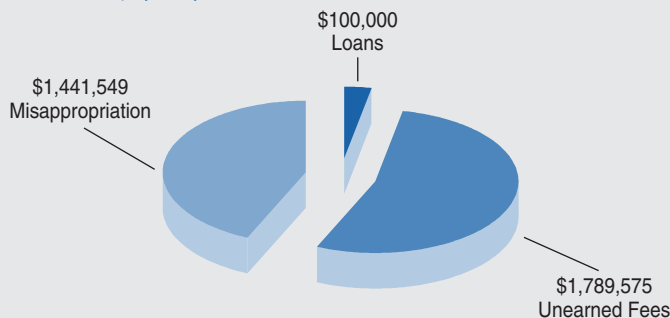
Number of Applications Paid by Category in 2010
Total: 267



Dollar Amount of Applications Paid by Category

In 2010, the largest number of applications paid and the largest dollar amount paid were in the "Unearned Fees" category, \$1,789,575 or approximately 53.7%. "Misappropriation" cases comprised the second largest dollar amount of applications paid, \$1,441,549 or approximately 43.3%. The remaining small percent of the total payouts was for "Loans."

Dollars Paid by Category in 2010
Total: \$3,331,124



General Basis for Reimbursement

An applicant must establish the loss of money or property that was received by an active attorney or an attorney acting in a fiduciary capacity customary to the practice of law, and which loss was caused by a dishonest act as defined under the rules.

Rule of Limitations

Applications for reimbursement from the Fund must be filed within four years after the applicant discovers or reasonably should have discovered the loss.

Status of the Lawyer

In order for reimbursement to be paid, the lawyer whose dishonest conduct caused the loss must have been acting as a lawyer, or in a specified fiduciary capacity, such as the trustee of an express trust or as an escrow holder.

Also, the lawyer must have been disciplined, voluntarily resigned, died, been found mentally incompetent or been judged guilty of a crime that involved the loss. The Rules do give the Commission the discretion to waive this requirement under certain limited circumstances - for example, in clear cases when formal charges have been filed but the lawyer has not yet been disciplined.

Dishonest Conduct

A lawyer's dishonest conduct that can lead to payment from the Fund includes:

- theft or embezzlement of money or the wrongful taking or conversion of money or property;
- failure to refund unearned fees received in advance when the lawyer performed an insignificant portion of the services or none at all;
- the borrowing of money from a client without the intention or the reasonable ability to repay it;
- obtaining money or property from a client for an investment when no investment is made; or
- an act of intentional dishonesty or deceit that proximately leads to the loss of the money or property.

Losses not Covered

The Fund will not reimburse a loss if:

- it was covered by insurance, a bond or another fund;
- it was caused by negligence or malpractice; or
- it was a bad business loss such as a failed investment.

The Fund also does not cover "interest," "incidental or consequential losses" or "expenses" caused by the attorney. Examples of incidental or consequential losses would include fees applicant paid to another attorney or damages caused by malpractice, negligence or incompetence.

"I am writing in to thank everyone involved in the process of my application with the State Bar. I am a very satisfied consumer that cannot thank you enough. You have helped my family and I recover a big amount of money that was paid out to a person that took advantage of our situation and betrayed our trust. I am so appreciative of the professional and efficient service I received from your agency."

(Quote from Applicant 2010)

Legislation

Oversight of the Client Security Fund is provided by the Legislature through a series of statutes, and by the Bar's Board of Governors through the Client Security Fund rules.

The State Bar's authority to operate the Client Security Fund is found in Business & Professions Code section 6140.5. This Legislation, effective March 4, 1972, was a result of a Board resolution dated June 17, 1971 and a Bar-sponsored bill. Section 6140.5(a) requires the Board to maintain a Client Security Fund.

Effective January 1, 2006, Section 6140.5(a) was amended to expand the purpose of the Client Security Fund to include relieving or mitigating pecuniary losses caused by the dishonest conduct of Foreign Legal Consultants registered with the State Bar and attorneys registered with the State Bar under the Multi-jurisdictional Practice Program.

Section 6140.5(b) provides a special statute of limitations whereby the Bar may bring an action to enforce its subrogation rights within three years of the date of payment to an applicant. Another part of the Bar's effort to collect against the errant lawyer is section 6140.5(c) which allows the Bar to add any CSF payout, plus interest and processing costs, to the membership dues bill of any lawyer who has been disciplined or resigns with discipline matters pending and seeks to be reinstated.

Section 6140.5(d) allows certain fund payments to be enforced as money judgments pursuant to Division 2 (commencing with Section 695.010) of the Code of Civil Procedure. This subdivision does not limit the power of the Supreme Court to alter the amount owed or to authorize the State Bar Court, in the enforcement of a judgment under this subdivision, to approve an agreement for the compromise of that judgment.

Section 6140.55 currently allows the Board to assess annually up to \$40 per active member and \$10 per inactive member to support the Fund. This assessment is to be used only for the purposes of the Fund.

Section 6149.5 serves as an early loss prevention measure. It requires insurers to provide written notice to a claimant of settlement payments of \$100 or more delivered to the claimant's lawyer or other representative in settlement of any third-party liability claim.

Another statute that affects the Fund is section 473 of the Code of Civil Procedure. Under this section, when a court sets aside a default judgment due to a party or attorney's mistake, inadvertence, surprise or excusable neglect, it may (1) impose a penalty of no more than \$1,000, (2) direct the offending attorney to pay up to \$1,000 to the Client Security Fund, or (3) grant such other relief as appropriate. Under this statute, the Fund received \$12,525 in 2010.

"I sincerely thank you and other members of the California State Bar of California. Since I am an 85-year-old widow, the sum of \$19,975.00 really has made a difference. What you have done for me seems like a miracle, and I thank you again and again and again."

(Quote from Applicant 2010)

Commission Members



Joyce L. Hurley, a public member, is a paralegal in a private legal firm in Los Angeles. She was appointed in September 2005 and serves as Chair for 2009-2010. Her term expires in September 2010.



Paul S. Hokokian, an attorney member and former Board member, is currently a sole practitioner in Fresno. He was appointed in September 2008 and serves as Chair for 2010-2011. His term expires in August 2011.



Howard Caldwell, a public member, is a self-employed consultant in labor management relations. He was appointed in September 2008 and serves as Vice Chair for 2010-2011. His term expires in August 2011.



Colleen Dietz, a public member, is a Director of Professional Development Programs, at USC. She was appointed in September 2009. Her term expires in September 2012.



Douglas J. Hartsough, an attorney member, is currently a sole practitioner in Brentwood in Northern California. He was appointed in November 2009. His term expires in October 2013.



Linda Monroe, an attorney member, is currently a sole practitioner. She was appointed in September 2009. Her term expires in September 2012.



Wendy Oshiro, an attorney member, is currently a real estate analyst in Los Angeles. She was appointed in September 2008. Her term expires in August 2011.

"I would like to thank you, for all your patience in me, in behalf of my family, this money could save our house in Sacramento god willing."

(Quote from Applicant 2010)

"A quick note to thank you and tell you how pleased (and amazed) I was to receive payment from your fund!"

(Quote from Applicant 2010)

"Thank you for helping me. It's people like you that helps to make the world go around."

(Quote from Applicant 2010)

"My faith in the system has been restored! Your office is to be commended on a job well done."

(Quote from Applicant 2010)

Decision Making

Policy oversight of the Client Security Fund is a joint responsibility of the Board of Governors and the Client Security Fund Commission. The seven member Commission acts as the Board's delegate in administering the Fund.

The Board monitors the Fund through its: appointment of seven commissioners; approval of recommended changes and additions to the Rules of Procedure; consideration and approval of the Fund's annual administrative budget; and power to seek legislative authority to increase the lawyer's fees that support the Fund.

The Board exercises its authority as an entity and through its Regulation, Admissions & Discipline Oversight Committee.

Of the seven volunteer members who comprise the Commission, no more than four of them may be lawyers. They are assisted by a professional staff of 9 who screen, analyze, investigate and present cases to the Commission. Staff is subject to Management oversight and reports to Colin Wong, the Chief Administrative Officer of the State Bar Court.

Among the Commission's key functions are:

- determining applications made to the Fund after a written and oral presentation of the matter by CSF staff and, occasionally, after hearing held before the Commission;
- recommending to the Board of Governors necessary staffing levels to carry out the Fund's business in a professional, timely fashion;
- taking steps to increase the efficiency and timeliness with which the Commission and staff process applications;
- monitoring the Fund balance and recommending to the Board of Governors necessary fee increases to guarantee its continued solvency;
- interpreting the Fund's rules of Procedure through policy statements and recommending necessary amendments and additions; and
- providing for the efficient inner workings of the Commission itself.



THE STATE BAR OF CALIFORNIA

Client Security Fund
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www.calbar.ca.gov
Discipline Complaint Hotline: (800) 843-9053

Financial Picture

To have a complete picture of the Fund's fiscal health, it is important not only to see what money is on hand and how much has been actually paid out, but to also know how much is expected to be paid on pending cases. This anticipated payout, or accrued liability, is calculated by multiplying the total dollar amount of the pending cases times an estimated claims payable ratio. The claims payable ratio is based upon how much the Fund has historically paid for every dollar claimed. For example, if the Fund has historically paid \$.30 for every \$1 claimed, then the claims payable ratio is 30 percent.

The claims payable ratio used by the Fund is based upon a 24-month rolling average. The accrued liability changes, not only with changes in the claims payable ratio, but also as the total dollar amount of outstanding applications changes.

Balance Sheet

The balance sheet shows the Fund's assets and liabilities as of December 31, 2010.

Fund assets are maintained in cash and cash equivalents.

Current liabilities include estimated awards ultimately to be paid on applications which are pending as of December 31 plus next year's dues payments received early - for example, 2010 dues received in 2009.

The Fund balance or deficit is simply the difference between Fund assets and accrued liabilities.

Statement Of Revenues, Expenses And Changes In Fund Balance

Total revenues consist of members' dues, interest income and other revenues such as Court ordered sanctions and occasional contributions.

Expenses include awards paid, accrued liabilities and administrative expenses. Awards constitute the major element. Off-set against this expense are any monies recovered from the bar's collection activities. This is reflected as "Awards Reimbursements or Recovery."

The Estimated Decrease/(Increase) in Awards Payable Liability is an adjustment made at the end of the year because of a change in the accrued liability.

"As they say in Hawaii, Mahalo Nui Loa. Thank you very much."

(Quote from Applicant 2010)

"Thank you very sincerely for the reimbursement it is greatly appreciated."

(Quote from Applicant 2010)

"I received your reimbursement check for the full amount that was in question. This is just to extend to you, and your organization our deepest thanks for your efforts and help, and all you undertook to get our funds returned. I admit that I had dim expectations of ever seeing any amount returned by any avenue. Please pass this along to others involved whom I would like to have know that we are very, very thankful to you all."

(Quote from Applicant 2010)

2008 - 2010 BALANCE SHEET STATEMENTS

| | AUDITED 12/31/08 | AUDITED 12/31/09 | UNAUDITED 12/31/10 |
|--|---------------------|---------------------|-----------------------|
| ASSETS: | | | |
| Cash | 10,579,890 | 11,474,262 | 15,522,370 |
| LIABILITIES & FUND BALANCES: | | | |
| Current liabilities | 6,275,371 | 8,795,297 | 13,200,055 |
| Net Assets | 4,304,519 | 2,678,965 | 2,322,315 |
| Total liabilities & Fund balances | 10,579,890 | 11,474,262 | 15,522,370 |

2008 - 2010 STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND BALANCES

| | AUDITED 12/31/08 | AUDITED 12/31/09 | UNAUDITED 12/31/10 |
|--|---------------------|---------------------|-----------------------|
| REVENUES: | | | |
| Membership dues | 6,715,339 | 6,872,572 | 6,983,974 |
| Investment Income | 422,005 | 145,501 | 79,494 |
| Other/Miscellaneous Revenues | - | 6,500 | 17,120 |
| TOTAL REVENUES | 7,137,344 | 7,024,573 | 7,080,589 |
| EXPENSES: | | | |
| Awards Paid/Accrued | 4,458,375 | 7,343,982 | 6,235,638 |
| Less: Awards Reimbursements or Recovery | (425,949) | (615,485) | (418,964) |
| CSF Claims Collection Exp. | 56,920 | 62,933 | 2,109 |
| Total | 4,089,346 | 6,791,431 | 5,818,783 |
| Administration | 1,734,368 | 1,858,696 | 1,618,456 |
| TOTAL EXPENSES | 5,823,714 | 8,650,127 | 7,437,239 |
| EXCESS (DEFICIT) OF REVENUES OVER EXPENSES | 1,313,630 | (1,625,554) | (356,650) |
| Estimated Decrease / (Increase) in Awards Payable Liability | 184,487 | (3,883,423) | (2,907,979) |
| Net Assets, as of year-end | 4,304,519 | 2,678,965 | 2,322,315 |

"I am writing to thank you sincerely for your reimbursement of the \$3,500."

(Quote from Applicant 2010)

CLAIMS ACTIVITY 2002 - 2010

Nine-year Comparison

| | # of Claims | 2002 Amount | # of Claims | 2003 Amount | # of Claims | 2004 Amount | # of Claims | 2005 Amount | # of Claims | 2006 Amount | # of Claims | 2007 Amount | # of Claims | 2008 Amount | # of Claims | 2009 Amount | # of Claims | 2010 Amount |
|--|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Claims outstanding, beg. of year | 751 | 9,517,404 | 770 | 10,157,007 | 759 | 8,548,576 | 858 | 9,956,622 | 787 | 10,396,199 | 797 | 9,579,525 | 787 | 11,811,143 | 710 | 11,871,541 | 2,997 | 22,124,850 |
| Prior year's outstanding claim adjustment | 5 | 29,491 | (2) | 55,611 | (13) | 109,900 | (3) | 90,040 | (2) | 241,984 | - | 69,048 | - | 107,497 | - | 15,532 | - | 100,260 |
| New claims | 1,300 | 14,166,217 | 1,200 | 12,221,905 | 1,321 | 13,681,482 | 1,318 | 11,558,645 | 1,314 | 10,916,591 | 1,013 | 12,927,446 | 825 | 11,290,084 | 3,028 | 19,469,661 | 3,875 | 23,231,936 |
| TOTAL CLAIMS | 2,056 | 23,713,112 | 1,968 | 22,434,523 | 2,067 | 22,339,958 | 2,173 | 21,605,307 | 2,099 | 21,554,774 | 1,810 | 22,576,019 | 1,612 | 23,208,724 | 3,738 | 31,356,734 | 6,872 | 45,457,046 |
| Less: Processed Claims: | | | | | | | | | | | | | | | | | | |
| Paid | 782 | 6,597,057 | 701 | 5,859,620 | 746 | 5,681,455 | 982 | 4,648,584 | 943 | 5,299,061 | 607 | 4,352,110 | 479 | 4,638,272 | 378 | 3,461,950 | 267 | 3,331,124 |
| Rejected | 39 | 2,580,784 | 39 | 2,585,959 | 39 | 1,701,671 | 50 | 2,535,698 | 24 | 1,799,629 | 42 | 2,066,308 | 57 | 2,196,878 | 52 | 1,930,226 | 138 | 2,869,032 |
| Withdrawn | 465 | 4,378,264 | 469 | 5,440,368 | 424 | 5,000,210 | 354 | 4,024,826 | 335 | 4,876,559 | 374 | 4,346,458 | 366 | 4,502,033 | 311 | 3,839,708 | 355 | 4,743,243 |
| TOTAL PROCESSED CLAIMS | 1,286 | 13,556,105 | 1,209 | 13,885,947 | 1,209 | 12,383,336 | 1,386 | 11,209,108 | 1,302 | 11,975,249 | 1,023 | 10,764,876 | 902 | 11,337,183 | 741 | 9,231,884 | 760 | 10,943,399 |
| Claims outstanding, end of year | 770 | 10,157,007 | 759 | 8,548,576 | 858 | 9,956,622 | 787 | 10,396,199 | 797 | 9,579,525 | 787 | 11,811,143 | 710 | 11,871,541 | 2,997 | 22,124,850 | 6,112 | 34,513,647 |
| Claims outstanding inc./(dec.) over beginning balance | 19 | 639,603 | (11) | (1,608,431) | 99 | 1,408,046 | (71) | 439,577 | 10 | (816,674) | (10) | 2,231,618 | (77) | 60,398 | 2,287 | 10,253,309 | 3,115 | 12,388,797 |
| Claims payout ratio | | 44.20% | | 45.26% | | 43.88% | | 43.79% | | 42.86% | | 42.45% | | 40.68% | | 39.38% | | 33.67% |
| Est. claims liability at payout ratio | | \$4,489,397 | | \$3,869,086 | | \$4,368,966 | | \$4,552,496 | | \$4,105,784 | | \$5,013,830 | | \$4,829,343 | | \$8,712,766 | | 11,620,745 |
| NET ASSETS (end of year) | | \$5,656,285 | | \$4,303,609 | | \$2,229,455 | | \$1,479,897 | | \$2,325,593 | | \$2,990,889 | | \$4,304,519 | | \$2,678,965 | | 2,322,315 |
| NET ASSETS (end of year, cash-basis) | | \$10,145,682 | | \$8,172,695 | | \$6,598,421 | | \$6,032,393 | | \$6,431,377 | | \$8,004,719 | | \$9,133,862 | | \$11,391,731 | | 13,943,060 |